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THE ASSAULT THAT FAILED: THE PROGRESSIVE CRITIQUE OF LAISSEZ FAIRE

Richard A. Epstein*

THE PROGRESSIVE ASSAULT ON LAISSEZ FAIRE: ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT. By *Barbara H. Fried*. Cambridge: Harvard University Press. 1998. Pp. x, 338. \$55.

PLAYING FOR ALL THE MARBLES

Robert Lee Hale has long been an intellectual thorn in the side of the defenders of laissez faire, among whom I am quite happy to count myself. As Barbara Fried¹ notes in her meticulous study of Hale's work, his name is hardly a household word. But both directly and indirectly, his influence continues to be great. His best known work is perhaps *Coercion and Distribution in a Supposedly Non-Coercive State*,² published in 1923 as a review of Thomas Nixon Carver's *Principles of National Economy*,³ itself a defense of the classical principles of laissez faire, remembered today only for the drubbing that it took at Hale's hands. Hale also wrote one of the early influential treatments of the problem of "unconstitutional conditions," which addressed the still-perplexing question of the implicit coercion in the government's power to attach unpalatable conditions to its own contracts or grants.⁴ He wrote a number of influential attacks on the principle of freedom of contract.⁵ He took an active role (pp. 186-89) in overthrowing the dominance of *Smyth v. Ames*,⁶ which for the better part of two generations fixed

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1. Professor of Law and Deane Johnson Faculty Scholar, Stanford Law School.

2. Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923).

3. THOMAS NIXON CARVER, *PRINCIPLES OF NATIONAL ECONOMY* (1921).

4. See Robert L. Hale, *Unconstitutional Conditions and Constitutional Rights*, 35 COLUM. L. REV. 321 (1935).

5. See, e.g., Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603 (1943). The same issue of the Columbia Law Review contained Friedrich Kessler's famous, if misguided, attack on standard form contracts. See Friedrich Kessler, *Contracts of Adhesion — Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

6. 169 U.S. 466 (1898).

the "fair value" limitation as a restraint on the state power to regulate railroads and other public utilities. Although his work is not as well known in general intellectual circles today as that of T.H. Green⁷ or Leonard Hobhouse,⁸ (who both receive much attention from Fried), Hale has a low-key durability that ranks him as one of the most formidable and persistent foes of laissez faire in the first half of this century.

To be sure, a steady stream of distinguished authors has taken note of his positions and has sought, generally, to build upon them.⁹ But Fried is the first writer to devote a long-overdue, full-length monograph to his work. Hers is, without question, a careful and sympathetic portrait of Hale. Her mission is to persuade the reader that his insights are lasting and his continued influence fully deserved. Fried has had access to Hale's private papers and is thoroughly conversant in nineteenth century intellectual forces in both Great Britain and the United States. At every point she gives due credit to the many earlier writers who helped to shape Hale's views. Indeed, her copious footnotes are a treasure trove of information for anyone who wants to study further the intellectual origins of the progressive tradition.¹⁰

Not surprisingly, Fried also identifies strongly with Hale's substantive positions. Most concretely, she claims that his conceptual framework "allowed him to make three crucial and largely irrefutable points" (p. 18). These are, first, that coercion, properly understood, is "ubiquitous, inevitable, and, to a considerable extent, desirable"; second, that coercion is measured by its target and not by its source, so that individuals can be coerced either by natural necessities or by legal rules; and third (in consequence of the first two), that the Supreme Court could not rely on any constitutional theory that sought to "condemn state interference with private choices merely on the ground that it was factually coercive" (p. 18). In the end, however, Fried cannot rehabilitate ideas that, however alluring, were unsound the day they were penned and have proved

7. See, e.g., T.H. Green, Lecture, *Liberal Legislation and Freedom of Contract* (1881), in *THE POLITICAL THEORY OF T.H. GREEN* 43-74 (John Rodman ed., 1964).

8. See, e.g., L.T. HOBHOUSE, *LIBERALISM* (1911), reprinted in *LIBERALISM AND OTHER WRITINGS* (James Meadowcroft ed., 1994) at 1.

9. Fried lists the recent contributions at p. 217, n.2. They include: Neil Duxbury, *Robert Hale and the Economy of Legal Force*, 53 *MOD. L. REV.* 421 (1990); Pavlos Eleftheriadis, *Unfreedom in a Laissez-Faire State*, 80 *ARCHIVES FOR PHIL. L. & SOC. PHIL.* 168 (1994); and Duncan Kennedy, *The Stakes of Law, or Hale and Foucault!*, in *SEXY DRESSING ETC.* 83 (1993). The titles indicate the widespread support for Hale's position, which has also been invoked by such distinguished scholars as Robert Gordon, Morton Horwitz, Frank Michelman, Gary Peller, and Cass Sunstein.

10. But with this caveat: with such voluminous notes, the references should be more explicitly cross-referenced to the first citation of a given work, and a full biography should be included at the back to give greater access.

ever more untenable with the passage of time. The bottom line is this: Hale was an ingenious scholar, but a systematic failure.

To defend this harsh conclusion, it is necessary to recap in brief form the main principles of laissez faire theory, with its economic, institutional, and constitutional dimensions. Its central tenets attach great importance to individual liberty, private property, freedom of contract, and limited government. In its negative frame of mind, laissez faire takes a dim view of the use of force and fraud in human relations, and (in its sensible versions at least) worries about the dangers that flow from the use of monopoly power, whether acquired by legal grant or by hard labor mixed with good fortune. This last qualification is important, for, as Fried notes, the American version of the theory allowed a good deal more leeway to government than some of its Spencerian forbearers. More specifically, American laissez faire allowed government intervention to create infrastructure and other public goods. It also found the control of monopolies to be a legitimate government function, not only when these were created by operation of law, but also when they arose solely by private means.¹¹

By the same token, laissez faire also takes a cautious view of government power. Laissez faire is not a disguised form of anarchism, and it recognizes the need for state power to preserve public safety, health, and good order. It understands that the government must supply public infrastructure, and, in line with the Fifth Amendment, recognizes that the state may properly take private property for public use so long as it pays just compensation for it. Laissez faire constitutionalism had its strong defenders in the nineteenth century, among whom Thomas Cooley¹² and Christopher Tiedeman¹³ figure prominently.

Writing at the height of the progressive movement in American politics, Hale would have none of this. His major negative mission was to rip down the institutional and constitutional infrastructure upon which laissez faire rested. He thought that vast levels of legislative discretion over the regulation of economic affairs were proper. Toward that end, he believed that the major function of government was to improve the economic position of the working class. This single desire made him a staunch early defender of the Wagner Act, and a defender of various systems of wage and price controls that could prevent the rentiers who owned private prop-

11. P. 30. For a similar account, see Jacob Viner, *The Intellectual History of Laissez Faire*, 3 J.L. & ECON. 45, 45 (1960).

12. See THOMAS M. COOLEY, A TREATISE ON THE CONSTITUTIONAL LIMITATIONS (1868).

13. See CHRISTOPHER G. TIEDEMAN, A TREATISE ON THE LIMITATIONS OF POLICE POWER IN THE UNITED STATES (1886). Fried leads with Tiedeman in her introduction. See p. 1.

erty from reaping "supernormal returns" (p. 6), that is, any gains from the use of the property that were not necessary to prevent that property from being turned to another use.

Yet for all his obsessions, Hale curiously failed to defend his positive mission. Even though his political positions were relatively clear, he never quite tells us what the legislature should do with its power, or why it should do it, once it extricated itself from the false gods of classical constitutional law and laissez faire economics. Hale was much more comfortable whipping his enemies than developing his own positive vision. Indeed, given his methods, that is just what should be expected. Hale worked by intellectual demolition. The titles of Fried's key chapters capture his intensity. Her neutrally labeled "Introduction" is followed by heavy artillery. Chapter Two is devoted to "The Empty Idea of Liberty." Hard on its heels comes Chapter Three, "The Empty Idea of Property Rights." The term "empty" is meant to convey the strong philosophical condemnation of these bellwether conceptions of laissez faire. Hale was not content to show how liberty and property had lost their practical punch in the modern industrial age. Rather, emptiness stands for the intellectual bankruptcy on which it is impossible to build a coherent system of legal rights and duties, no matter what the social context. According to Hale, laissez faire could do no better by simple rustic societies than complex industrial economies.

But if these terms are incoherent, what philosophical vocabulary could do better? It seems equally likely that some astute critic will find some fatal contradiction in "human equality," "public interest," or "common good." Surely any determined critic could have a field day with "gender equality," or with "equalizing people's functional capacity to achieve a meaningful life,"¹⁴ or the countless egalitarian variations on these themes. The battle over political and legal theory will not be won by any deductive assault that proclaims the logical necessity of its own position and the conceptual incoherence of all rival camps — a lesson that applies to libertarian theorists as well as to champions of the welfare state.¹⁵ The great danger of throwing knockout punches is that they often backfire to cold-cock those who throw them.

Alas, Hale never quite understood the force of that observation. His great weakness was his determination to slay the dragon without pausing to consider what he would put in its place. The more

14. P. 206 (citing AMARTYA SEN, *INEQUALITY REEXAMINED* (1992), and Martha Nussbaum, *Aristotelian Social Democracy*, in *LIBERALISM AND THE GOOD* 203 (R. Bruce Douglass et al. eds., 1990)).

15. See RANDY E. BARNETT, *THE STRUCTURE OF LIBERTY* (1998), which I criticize on these grounds in Richard A. Epstein, *The Libertarian Quartet*, *REASON*, Jan. 1999, at 61.

sensible theoretical position starts from the premise that any legal order necessarily depends on second-best accommodations that are needed precisely because first-best solutions are never obtainable. Pure conceptual arguments are necessarily limited in their scope and power. They can remove ambiguity; they can eliminate contradiction. But, in the end, these preliminaries only serve to beef up the rival theories — libertarianism, socialism, progressivism, liberalism, egalitarianism, totalitarianism — which have to stand or fall on some rough empirical estimation of their relative strengths and weaknesses. Because he never quite grasped this point, Hale was too confident in his negative case against traditional *laissez faire*, and too sketchy in his own affirmative case. As Fried lamely concludes, “while Hale’s argument was analytically radical, it did not lead necessarily to politically radical conclusions” (p. 210). Hale was too knowledgeable about the merits of competition as a socialist, and too concerned with incentives to be an unstinting egalitarian. Fried is right to say that he is best understood to be part of the tradition of Hobhouse, Dewey, Lippmann, and other social democrats who sought to find “a middle way between the new socialism and the old liberalism” (p. 233 n.35).

Nevertheless, the team of Hale and Fried has been touted as having made “one of the best demolitions, in law or political theory, of that contested concept [of *laissez faire*].”¹⁶ But Hale accomplishes nothing this grand, as Fried herself reluctantly recognizes. To be sure, throughout the early parts of the book, Fried praises Hale’s analytical power. But in her more guarded and textured Conclusion, she offers a much more candid assessment of the “more solid, functionalist footing” that he sought to create.

Nothing logically followed from that change in Hale’s view, beyond the all-important conclusion for Hale’s contemporaries that most legal questions were questions of policy for the legislature, not matters of constitutional rights for the courts. How legislatures ought to resolve them was, of course, another matter, and one on which Hale’s skeptical, deconstructive analysis offered little guidance. This omission will no doubt strike many modern readers of Hale’s work as its most serious limitation. [p. 210]

Right on! In reality, the situation is much worse than this. The cupboard empty of constructive proposals for reform should lead us to doubt Hale’s negative program. Ingenious and provocative it may be — but wrong, and ultimately wrong-headed as well. To defend this assessment, it is useful to analyze his ideas in exactly the order that Fried discusses them. The first section of this review analyzes Hale’s critiques of liberty and property. The second examines his position on the progressive obsession with the unearned incre-

16. As asserted on the jacket cover by my colleague Cass Sunstein.

ment of private property. The third deals with Hale's views on rate regulation. He is wrong about all three.

THE "EMPTY" IDEA OF LIBERTY

As noted above, the fundamental distinction for a laissez faire system is that between coercive exactions and voluntary transactions. The key element of the voluntary transaction is that it only takes place when it produces benefits to both participants. It therefore results in a positive sum game for its players, which presumptively means that it should be enforced unless it imposes some larger offsetting disability on third parties. It is this simple insight that led, for example, to the constitutional protection of freedom of contract in *Coppage v. Kansas*.¹⁷

On the other side of the line are those transactions whose voluntariness is vitiated by force or fraud. In these cases, the assumption of mutual gain no longer holds. People will yield property if faced with the threat (or left with the choice) of their money or their life; people will make silly trades if made to believe that the property or service they receive is worth more than it really is. The system of private contract law seeks primarily to use public force to enforce positive sum games while withholding enforcement from negative sum games. Contracts are likely to be negative sum games when their background conditions are such as to make one party a systematic ex ante loser. To identify such cases requires that one be able to distinguish between coercive and noncoercive transactions.

Hale's major thrust is to undermine this program by asserting that the term "coercion" has no intelligible meaning. To Hale, coercion in the private arena was not limited to the use or threat of physical force by one person against another. Nor was it so limited in the public sphere in connection with state action directed against private persons. Rather, as Fried notes, coercion covered much more ground for Hale — indeed it covered just about all the ground. Thus Hale claimed that coercion "took the form of background constraints on the universe of socially available choices from which an individual could 'freely' choose."¹⁸ Armed with this broad definition of coercion, Hale directed his fire to the "so-called voluntary market exchanges, in which each side coerced the other to relinquish its property or services by a (legally sanctioned) threat

17. 236 U.S. 1 (1914).

"Indeed a little reflection will show that wherever the right of private property and the right of free contract co-exist, each party when contracting is inevitably more or less influenced by the question whether he has much property, or little, or none; for the contract is made to the very end that each may gain something that he needs or desires more urgently than that which he proposes to give in exchange."

236 U.S. at 17.

18. P. 17; see also p. 36.

to withhold its own property or services if the demanded terms were not obtained in exchange" (p. 17).

The obvious targets of this position were the classical laissez faire theorists such as Herbert Spencer and Carver who championed "the dogma of noninterference" in contractual relationships (pp. 29-30). In a constitutional framework, Hale's critique meant that the Supreme Court could no longer defer to private choices on the grounds that these choices were noncoercive, while public choices were always coercive. That critique brought into the crosshairs of progressive jurisprudence *Lochner v. New York*,¹⁹ which struck down a ten-hour workday for certain types of bakers in New York; *Adair v. United States*²⁰ and *Coppage v. Kansas*,²¹ which struck down statutes that made it illegal for employers to insist on yellow-dog contracts, in which working for the firm was made explicitly conditional on not joining a union; and *Hitchman Coal & Coke Co. v. Mitchell*,²² which held that the tort of inducement of breach of contract could be used directly against a union that encouraged workers to join it secretly in breach of their contractual undertaking. All of these decisions are quite sound if the traditional account of coercion is correct — a concession that Hale never explicitly made. But they are clearly suspect if Hale's insistence on broader background conditions carries the day.

How does Hale make his claim work? In his famous attack on Carver's *Principles of National Economy*, Hale argues that the refusal to accept any terms proffered is always coercive, regardless of the dominant market structure. But there is nothing to back up this claim. Hale gives the instance of a prospective employer who coerces a prospective employee by demanding that the latter work at a lower wage.²³ But since his account of coercion is not role-specific, he has to acknowledge that the employee coerces the employer when the employee asks for higher wages.²⁴ Indeed, coercion is not confined to employment relations but covers all so-called voluntary transactions. So any trade between merchants, any marriage, any joint venture, or any supermarket purchase is also tainted by coercion, even if the mutual gain assumption holds for the contracting parties. The thought that prices and wages communicate something about the opportunity costs of goods and labor, so that individuals and firms will have some sense of the scarcity value

19. 198 U.S. 45 (1905).

20. 208 U.S. 161 (1908).

21. 236 U.S. 1 (1914).

22. 245 U.S. 229 (1917).

23. See Hale, *supra* note 2, at 472-73.

24. See *id.* at 474 ("In paying high wages to wage-earners . . . he is [influenced by their will]. But for their will to obtain the high wages, and their power of backing up that will, he has no reason for paying them. Yet he does. What else is 'coercion'?").

of human and material resources, nowhere enters into Hale's analysis. Hale also never addresses the insights of F.A. Hayek²⁵ on the point, even though Hale remained an active scholar through the 1940s when the socialist calculation debate had more or less run its course. The possibility that competitive markets constrain the degree of coercion by allowing for new entry is likewise a point that Hale never examines.

The irony here is palpable. Hale complains that the traditional definitions are muddled and confused (p. 206). But he never confronts the obvious objection that his own definition of coercion is so broad that it sweeps every form of human conduct within it. In the end, Hale tells us nothing at all, for, as Fried acknowledges in the end, refusals to deal in competitive markets must at some level be distinguished from the gun-to-the-head scenarios to which Hale analogizes such refusal.²⁶

The evident vice of Hale's analysis is to make coercion into a useless construct that purports to cover an infinite array of cases. Yet if Hale were right, just what should be done once it is no longer possible to expunge coercion from human affairs? If the older laissez faire system does not work, what should replace it? How do we decide which forms of social coercion are permissible and which are not? On this score, Hale says nothing that would lead anyone to conclude that the traditional uses of force are mysteriously non-coercive. His analysis would persuade no one to legalize murder and robbery. So his real task is to identify what other forms of ostensible market behavior should be regarded as coercive as well.

One obvious candidate, just noted, for special treatment is the behavior of monopolies, which (as will be discussed presently) was already done under the prevailing intellectual and constitutional doctrines that Hale attacked. But for Hale, and for so many progressives, their loose talk about coercion runs the system into reverse. Competition is called coercion; and the creation of a state monopoly for labor is defended in the name of liberty of contract. Of course, this works in favor of those union members whom Hale championed. But what is so striking about his position is its *antisocial* component, for he never asks who is hurt by the new rights he creates. Employers don't seem to have a utility worth preserving, even if they have devoted their entire lives to their businesses. Rival workers who are excluded by union organizations just don't count. And consumers, many of whom work in other industries,

25. See F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945). Fried makes only one passing reference to Hayek's work, p. 35, even though Hayek is in some sense the antithesis of Hale.

26. "There remains a difference, after all, between pointing a gun at another's head and demanding 'Your money or your life,' and threatening to withhold bread from a starving person unless she consents to pay the market price." Pp. 211-12.

don't count either. Instead, what Hale does is endorse a system in which competitive labor markets are transformed by law into monopolistic ones. In some cases, collective bargaining leads only to marathon negotiations that end in an agreement. In other cases, the government-created structures lead to strikes that disrupt industrial production, or worse, shut down various service industries, causing massive inconvenience measured at a global level. Yet Hale does not offer us a single word that might allow us to understand, thinking only in contemporary terms, why the shutting down of Major League Baseball in 1994 or the NBA strike of 1998 should count as a good thing; or why airline strikes should be allowed to cripple entire segments of the nation so that airline pilots and mechanics can continue to earn monopoly rents. In the end, Hale's talk about the widespread and inevitable use of coercion removes from the table the one intellectual construct that could allow for a coherent social policy on these issues. In its stead we get a narrow-minded boosterism of one side in an industrial struggle, without any appreciation of the dislocations that his cheerleading causes.

Hale was right about one thing, however. The constitutional orientation contained in *Lochner*, *Adair*, and *Coppage* does depend on the soundness of the laissez faire definition of coercion that underlies it. But he, like Fried, shrinks away from the key consequence of that position. Should Hale be wrong on the definition of coercion, the progressive critique of these classical constitutional decisions breaks into pieces. *Lochner* is not a case which allows employers to exploit their workers. Rather, it becomes a case where the small immigrant baker firms are allowed to operate in competition with the larger domestic firms that seek to put them out of business by disguising blatantly anticompetitive measures as health statutes. Even Hale should have taken pause that *Lochner* was not sued by his workers. He was prosecuted by a state eager to "protect" workers out of their jobs. Rightly understood, *Adair* and *Coppage* are easier cases to defend on their merits because the state interference (by force of course) with freedom of contract does not even have the fig leaf of health or safety to justify it. Rather, both cases struck down legislation that wanted to displace a competitive labor market with a monopolistic one in exchange for purported social gains that have yet to be identified.

If these decisions are correct, then so too is *Hitchman Coal*, for, as Fried herself acknowledges (p. 231 n.26), unless the action for inducement of breach of contract is allowed, then the hapless employer is left with the task of having to sue or dismiss all of his employees individually, assuming that he can show that they have covertly joined the union. An injunction against the third party, however, stops the organizing activity in its tracks. That much, the progressives of all generations are prepared to concede. But what

is their justification for knocking out the inducement tort in these cases? Surely it cannot rest on the view that the employer has engaged in state action when he calls on the state to enforce its contract and the property laws. Hale claimed that employers received a form of "delegated" power from the state (p. 65), which carries with it the ominous conclusion that anyone who wants to keep other people from meddling with his or her body or land can only do so if the state decides to delegate that right to exclude. The only way to defeat the traditional view of natural rights seems to be worse than the disease. It is to assume that in a constitutional government, the state, through its power of definition, has absolute control over the liberties and fortunes of its citizens. What other conclusion could we reach by starting from the premise that liberty and property are empty concepts until state action infuses them with some measurable content?

Moving on, once *Adair* and *Coppage* are accepted as correct, Hale's attack on the yellow-dog contract must fail as well. If labor contracts are as good as any others, then Hale must explain why inducement of breach of contract is an inappropriate cause of action in this context while valid in all others. The ill-fated English Trade Disputes Act of 1906²⁷ singled out inducement of breach of contract in labor disputes for special treatment. By removing the operation of the common law in this area alone, the Act led to the steady deterioration of labor relations in Great Britain, which helped assure its long-term decline as a world power.²⁸ A similar hostility to the tort was reached later in the United States under the Norris-LaGuardia Act²⁹ and finally under the Wagner Act,³⁰ which Hale so strongly defends.³¹ Once again, these statutes should be

27. 6 Edw. 7, ch. 47.

An act done by a person in contemplation or furtherance of a trade dispute shall not be actionable on the ground only that it induces some other person to break a contract of employment or that it is an interference with the trade, business, or employment of some other person, or with the right of some other person to dispose of his capital or his labour as he wills.

Id. § 3. The last clause, of course, was designed to attack the conception of individual self-ownership of labor that is central to the traditional common law view of capital and labor markets.

28. For some measure of the decline, see PAUL KENNEDY, *THE RISE AND FALL OF THE GREAT POWERS* 228 (1987) ("[British] industrial production, which had grown at an annual rate of about 4 percent in the period 1820 to 1840 and about 3 percent between 1840 and 1870, became more sluggish; between 1875 and 1894 it grew at just over 1.5 percent annually. . ."). The relative British decline between 1880 and 1914 was quite conspicuous, and its start coincided with the passage of the Employer Liability Act of 1880, 43 & 44 Vict., ch. 42.

29. 29 U.S.C. §§ 101-115 (1994). Section 103 denies injunctive relief for inducement of breach.

30. Wagner Act, Pub. L. No. 74-198, 49 Stat. 449 (1935) (codified as amended at 29 U.S.C. §§ 151-169 (1994)).

31. P. 6. The differences between the English and American positions are important, because the English courts and administration left labor contracts unenforceable, while the

deplored for their ability to create legal monopolies out of competitive industries. But Hale staunchly defends them, without making any analysis of their global consequences. And what does the Wagner Act prohibit? Section 8(1) makes it an unfair labor practice “to interfere with, restrain, or coerce employees in the exercise of [their rights to bargain collectively].”³² How could Hale support this act when it contains the terms “coercion, interference and restraint,” which he had found to be intellectually vacuous in his own academic writings? It’s amazing how conceptual clarity comes to those who enjoy political power! Ironically, here it really does suffer from that charge because the context of the statute makes it clear that coercion has to go beyond common law threats or use of force in order for the Wagner Act to effectuate what was doubtless intended — a major shift in the labor law. To this day, the law continues to struggle with these anomalies, and for what purpose?

There is another real cost to the conceptual blunderbuss that Hale wields. It makes it impossible for him to level more restrictive criticisms against positions that he disagrees with. As Fried recounts, Thomas Nixon Carver was anything but a consistent and thoroughgoing defender of laissez faire (p. 45). Carver’s *Principles* contains some suggestions for a program to eliminate poverty that seeks to raise the wage levels of the lower classes by government controls on income distribution, restrictions on immigration, lowering birth rates, subsidizing vocational education, and the like (pp. 45-46). Many of these proposals are costly or counterproductive, or both; certainly the restriction on immigration was one of the most hotly debated topics of his time, as it is in ours. As Fried notes, Carver thought that “one must always ask, ‘Are the results of repression or regulation worth as much as they cost?’ — cost, that is, in individual liberty” (p. 45). What she fails to point out is that Carver asked the right question to which he may have given the wrong answer. In contrast, Hale asked the wrong question when he sought to defeat the classical view of laissez faire on linguistic grounds. In so doing, he forfeited the opportunity to identify some specific adverse consequences of Carver’s program that should have led to the rejection of some of its key components.

This error is one that came back to haunt the defenders of the Progressive Era (whose leader, Woodrow Wilson, segregated the United States Civil Service shortly after he came into office). As Fried rightly notes, it hardly helps the defenders of free speech to note that the idea of liberty is empty and that coercion always lies in the eye of the beholder (p. 208). It surely embarrasses a civil

American system, in its search for the middle way, subjected first employers, and then unions, to comprehensive systems of direct regulation.

32. 29 U.S.C. § 158(a)(1) (1994).

rights movement to say that the state could, in the exercise of its discretion, justify segregated schools and antimiscegenation laws as a means to preserve racial purity (p. 208). But that is the price paid in condemning as incoherent the building blocks of any intelligible legal system. It is an especially high price to pay when the sophisticated critique is wrong and the traditional defender of *laissez faire* is, on this point at least, correct.

THE "EMPTY" IDEA OF PROPERTY

Hale does no better in his conceptual crusade against the empty idea of property. On this score, however, his attack takes a somewhat different though equally unpersuasive direction. When Hale wrote, the Civil War was of more recent memory, so that no one would argue that individual autonomy is "the creature of the state," which should be allowed only when used to advance the public interest. Even today the totalitarian implications of this position for such matters are too chilling to give it much appeal. But on matters of private property, Hale joined with a large band of socialists and progressives who found great comfort in stating that property was the creature of the state which could be used by private individuals only to the extent that it advances the common good. That position starts in a quite different place from the usual Lockean notions, which hold that taking first possession of an unowned thing removes it from the commons and reduces it to private ownership. The socialists and progressives all insisted to some degree on a top-down system of property rights. But by the same token, the progressives (far more than the socialists) realized that many of the traditional incidents of private property had to be preserved "to foster moral self-development or productivity" (p. 72).

Reduced to a phrase, natural law justifications for private property were obviously out, but instrumental justifications were, grudgingly, in. Once more the point was strictly a matter of political judgment and convenience. The state which created private property could destroy private property when it no longer served the social ends for which it was designed. The implications for American Constitutionalism were clear. The protections afforded under the Contracts, Takings or Due Process Clauses were at best anomalous, and could not be invoked to resist any widespread system of social regulation done in the name of the common good. For these purposes, the common good included not only schemes that improved the lot of all individuals relative to some private property alternative, but also those schemes that served appropriate distributional ends, including assuring that all individuals have some minimum level of self-sufficiency. The basic drift of the position favored income redistribution so long as it did not trench too sharply into

the private incentives for production. The thought that various forms of common property, as with flowing water, could actually be more efficient than private property from a productive point of view did not register with Hale and his intellectual cohorts, depriving them of the strongest demonstration of the principled limitations on any well-functioning system of private property.³³

In responding to Hale and the progressives, it is, I think, important to recognize that one portion of their critique does make some sense. It is hard to defend the classical rules of property by some vacant appeal to natural law, as if the allure of the institution could only be denied on pain of self-contradiction. But the point is hardly dispositive of the overall exercise, for it only pushes back the inquiry to find the utilitarian basis on which any system of property has to rest and to which Hale himself was drawn (p. 73). Hale's combative nature leads him astray because he never asks the simple question of whether any genuine social advantages attach to the Lockean rule that awards property to its first possessor.

Yet these advantages are easy to identify. The first possession rule is relatively easy to apply. It guides potential disputants and allows them to take sensible steps to establish their claims by marking with fences or recordation. The rule also reduces uncertainty over ownership and allows property to be put quickly to productive use, or to be stockpiled until needed at some later time — a point of no little concern in the face of increased demands to preserve a pristine environment. The first possession rule also facilitates a coherent system of exchange. Because of these advantages, the principle "prior in time is higher in right" has earned its place in both common law and civil law systems.³⁴

By the same token, it would be foolish for any defender of *laissez faire* to follow the Lockean insistence that an ideal legal system has private ownership over all resources. Most obviously, the common law never took that view and had regimes of common property for water and for beaches. It also used state powers of eminent domain to condemn land for the construction of highways. Nor was it unsympathetic to the qualification and rejection of the first possession rule when it led to the premature destruction of natural resources, as with the well-rehearsed example of the fishery. The obvious point is that all individuals within the group can be made better off if consumption is deferred so that the stock can continue to produce sustainable yields over the long run. Some nat-

33. For my recent elaboration of this theme, see RICHARD A. EPSTEIN, *PRINCIPLES FOR A FREE SOCIETY: RECONCILING INDIVIDUAL LIBERTY WITH THE COMMON GOOD* chs. 9 (Common Property) & 10 (Common Carriers) (1998).

34. For a fuller discussion, see RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* 50-93 (1995); Richard A. Epstein, *Possession as the Root of Title*, 13 GA. L. REV. 1221 (1979).

ural-rights diehards might dispute these conclusions, but most defenders of laissez faire are not troubled in principle with these forms of state intervention.³⁵ Rather, their affection for the rule of first possession creates a presumption which can be displaced only when its critics show its failings, relative to a system of regulation, in any particular case. It is not that the idea of private property is empty. It is that private property regimes have genuine shortfalls that in some circumstances can be countered by intelligent state action. It is for this reason, and none more profound, that we have a different attitude to the limitation on individual liberty and autonomy. The competition in labor markets does not lead to the same social dislocations as overfishing or overhunting.

If Hale and the progressives had contented themselves with this critique, then little would separate them from the intelligent defenders of laissez faire. But Hale is not content with these half-measures. Instead he once again goes for the knockout blow. His first point is that the common law rule of first possession is necessarily flawed because it gives the first possessor the benefit of the unearned rent. Indeed the principle is far broader. As Fried summarizes, "individuals are entitled to a portion of their social product, equal to a fair return on cost or sacrifice; but the surplus above that is rightly society's, to do with as it sees fit" (p. 213). Thus those individuals who own, for example, superior land that requires little cultivation should be able to retain from the price of goods sold an amount sufficient to cover their labor. But the unearned increment from the superior land should be turned over to the state.

Fried is drawn to Hale's view on this point because it shows the "soft underbelly of libertarian Lockeanism" (p. 213). She continues:

The difficulty of justifying a right to surplus value continues to plague many contemporary libertarian theories. Robert Nozick's principle of "justice in transfer," for example, elaborated in *Anarchy, State, and Utopia*, assumes (and in turn purports to shore up) a private right to whatever exchange price the market will bear. But as Nozick himself concedes, that principle is not always easy to defend. It is also inconsistent with Nozick's own treatment of surplus value or rents elsewhere in *Anarchy, State, and Utopia*. So also, much of Richard Epstein's *Takings*, the best-known recent attempt to translate libertarian principles to a legal regime, rests on the (undefended) assertion that individuals have a right to appropriate the surplus value created by society, in proportion to the value of assets that they bring into society from a hypothetical state of nature. [p. 213; footnote omitted]

35. And it all fits in quite well with the Takings Clause. See RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* 216-28 (1985) (chapter 15 dealing with "property and the common pool").

It is useful to note that, having made these criticisms, Fried rightly thinks that Hale's effort to extract the unearned surplus from all market transactions is doomed to failure on simple practical grounds. No one knows how much cost or sacrifice is involved in any particular transaction, and no one wants to bear the enormous administrative costs and invasions of privacy that it would take to find all this out. The simpler approach to this problem is to tax the gain on each transaction (the amount received less the cost basis), and to assume that taxation on those gains serves as a rough proxy for the amount of benefits that individuals receive from state intervention.

These remarks help to justify my (undefended) assumption that individuals should share in social gains in proportion to their contributions to public events. But I thought that I gave a rather more extensive justification for that position in both *Takings* and *Bargaining with the State*.³⁶ One part of that defense is that the size of the social surplus is not independent of the rules used to decide its division. Let individuals think that the social surplus is always up for grabs, and they will spend resources to deflect as large a fraction of that surplus to their own private ends. In the end, thrust and riposte dissipate any surplus created by state action. The central function of the Takings Clause is to make sure that the state does not take on projects with a negative expected value (which is why compensation has to be paid when property is taken). But the avoidance of loss is not the same as the maximization of gains. To meet that last challenge, the central function of the unconstitutional conditions doctrine is to stabilize the surplus in connection with positive sum transactions that should be undertaken.

That observation, standing alone, does not tell us *which* division of the surplus is appropriate. Here the theoretical ground for its proportionate division seeks to make public transactions imitate the private arrangements that are used to address similar problems. Thus, when a promoter sells shares of a corporation, the usual agreement divides the gains in accordance with the amount of money invested in the business. The whole point here is to equalize the rate of return across different investments. Any other system of allocation which promises higher returns to some individuals than it does to others will result in massive market distortions. Those who are to receive the low returns will abandon the project in favor of another that gives them the higher (risk-adjusted) market rate of return. Once the losers are gone from the project, then the remaining investors from Lake Wobegone all hope to receive above-average returns from their investment. Any effort to protect some

36. See EPSTEIN, *supra* note 35, chs. 1 & 12; RICHARD A. EPSTEIN, *BARGAINING WITH THE STATE* ch. 7 (Maximizing Social Surplus) (1993).

fraction of them with higher rates of return will lead to another exodus, leaving the same imbalance as before. The equalization of returns thus sets the stable equilibrium for private investments in collective goods. It therefore forms a focal point for the creation of public goods where private consensual arrangements cannot work.

The question of private investment is made more difficult given the power of shareholders to vote their shares. Should fifty-one percent of them by vote be able to cancel the shares of the remainder? Clearly not. No investment can take place under that extreme assumption. Accordingly, all private transactions combine a system of voting control with rules that protect shareholder stakes from expropriation. The majority can decide which ventures the corporation will undertake, but it cannot cut a minority out of its share of dividends or the proceeds of liquidation. The same risk of confiscation exists in the public sector, given the power of the vote. But here it is not possible to have a system that awards additional votes to people with larger stakes in the polity, given (at the very least) the enormous valuation problems in calculating the value of both human and physical capital. So we engage in a system of one person, one vote, and protect property from confiscation by the same structural protections that corporations and other joint ventures offer to induce private investment in the first place. Private property cannot be taken unless the public pays for it — a protection that is more important in the political arena than it is in the corporate arena, given that citizens cannot choose their fellow citizens but must take them as they are. The dangers of expropriation are at least as great as they are in private settings. How odd it is to assume that no constitutional protections are needed against majority forms of abuse.

How is this protection implemented when it is often difficult to measure the individual returns from public order? Individual returns from government action are not measured by some simple balance sheet calculation. Rather, they depend on the full range of consequences, good and bad, that comes from government action. In these circumstances, the direct measurement of surplus is usually not possible, so stabilization of surplus is best achieved by shifting to indirect measurements of equality. One obvious litmus test of unequal distribution of the surplus turns on the formal difference in positions. In one egregious case, white individuals are allowed to use public facilities to which black individuals are denied access. In other cases, there are no formal differences in the position of various individuals, but the disparate impact of the proposal is evident. Suppose that all individuals are told that they cannot make any further improvements to their land. If ninety percent of the people have built homes on their property, and ten percent have vacant lands, the disparate impact seems evident, and the takings analysis

yields only one answer: either the winners compensate the losers, or the regulation is struck down.

In light of this defense, it should be clear that in contrast to the Nozick of *Anarchy, State and Utopia*,³⁷ I am not a hard-core libertarian. Rather, I develop systematic rules to indicate when the state can take private property and what forms of compensation are appropriate. Unlike Fried, I refuse to follow in the statist footsteps of the progressives who claimed that "[i]f anyone had a right to surplus value . . . it was not any particular factor [of production], but rather society at large, to do with as it saw fit to further the common good" (p. 27). Society is not an individual but, like a corporation, it is an elaborate network of contracts that both allows private transactions and requires all (or some) individuals to contribute something to the enforcement system that the society operates to preserve the private rights that it protects. To commit to the state those resources above and beyond those necessary to run the system leaves open the question of *who* should get that unearned surplus. Even if no moral case can be made to show that the individual writer or composer deserves the surplus over the cost of labor from his compositions, nothing that Fried or anyone else has said shows that anyone else deserves this surplus, either. It would be a sad day indeed if we awarded some portion of the surplus to individuals whose sole contribution to the project is that they refrained from killing its author or burning his manuscript. The obvious point is that it is better to put the return in the hands of those who engage in creative activity rather than the undifferentiated mass that has done nothing but refrain from throttling him.

It may well be that with intellectual property, the right to exclude should not be perpetual given the near-zero costs of reproduction; the creation of monopoly rights does not come without social costs. But Hale's argument is not simply the traditional economic case for limited property rights over the diverse forms of intellectual property. It applies with equal force to land and other factors of production which, unlike intellectual property, cannot be consumed more than once. In these cases, the real question is to ask whether we would have a higher level of production if we could find a way to extract that unearned increment from its producer, or whether we are better off with the more modest ambition of leaving the state with the resources it needs to run the machinery of justice while keeping its hands out of a pot of gold that becomes a ripe target for political intrigue.

It's not that tough a question to anyone who voices a modicum of fear of rent-seeking activity. Never give the state a pot of gold, or even a cookie jar with loose change, that it can distribute

37. See ROBERT NOZICK, *ANARCHY, STATE AND UTOPIA* (1974).

through political means. Indeed, even the limited rights created in intellectual property meet this test, for it is not as though the state in its collective capacity takes the copyright or patent after the term for its private owner has expired, and then charges the monopoly price before distributing the proceeds to its favored friends. Rather, the composition or invention goes into the public domain where any and all can use it as they see fit. Allowing this property to fall in perpetuity into the public domain creates a resource base for all future generations that cannot be frittered away by government constraint and intrigue. If Hale and Fried have some reason why this public domain solution is inferior to the perpetuation of state monopolies, it remains far from apparent. What is clear is this: whenever the relative benefits and burdens of different devices are uncertain, then it is best in the long run to prevent all individuals, rich or poor, from seeking a disproportionate private share of the overall surplus. When we cannot calibrate the proportionate gain to surplus, it is better to let it lie, unmeasured, where it falls, than to subject it to the ravages of political machination.

THE REGULATION OF PUBLIC UTILITIES

The ideas of liberty and property are not empty, but they often can be defended by a fuller appreciation of the utilitarian arguments on their behalf. The same is true of the last target of Hale's wrath, the "fair value" rule for setting the rates that public utilities may charge. In this area, we should join in Hale's dissatisfaction with the naive libertarian approach. Thus libertarians are often uneasy about the creation of any state franchise (read, natural monopoly) in the first place: where does the state obtain that power to begin with? But throughout both English and American history, these franchises were issued, sometimes for good purposes and sometimes for bad.³⁸ The construction of bridges over public rivers could not take place unless the state allowed private individuals to build on common property. But no individual would make private investments over public waters if the state could launch a competitor nearby once its project was completed. Here, moreover, the original investor is not some firm displaced by a more efficient competitor. As Hale himself would have recognized, the second competitor could come in with a handsome government subsidy that would allow it to undercut the first entrant, even if its newer operation were less efficient. If only one bridge were necessary for all the

38. For a balanced and informative account of the early franchises, see HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW: 1836-1937* (1991).

traffic going over a key river, then who would want to bear the cost of constructing two?³⁹

Fortunately, the common law take on this subject was more nuanced than some idealized libertarian position. Here the key question was: What kinds of constraints should the state impose on any firm to which it granted some form of public monopoly? The answer, generally speaking, was that the firm in question was only entitled to a reasonable rate of return on its investment, and that it could not discriminate among the various customers for whom it supplied the only means of service or transportation. All of this was clearly established as early as the late seventeenth century, when Matthew Hale (no relation to Robert) noted that industries affected with the public interest were subject to state rate regulation to prevent the abuse of monopoly. Matthew Hale's discussion is short and worth quoting in full:

A man for his own private advantage may in a port town set up a wharf or crane, and may take what rates he and his customers may agree for crantage, wharfage, &c; for he doth no more than is lawful for any man to do, viz. make the most of his own," &c. — "If the King or subject have a *public* wharf, unto which all persons that come to that port must come and unlade or lade their goods, as for the purpose, because they are the wharfs only licensed by the Queen, according to the st. 1 Eliz. c. 11, or because there is no other wharf in that port, as it may fall out where a port is newly erected; in that case there cannot be taken arbitrary and excessive duties for crantage, wharfage, &c., neither can they be enhanced to an immoderate rate; but the duties must be reasonable and moderate, though settled by the King's licence or charter; for now the wharf and crane and other conveniences are affected with a public interest, and they cease to be *juris privati* only. As if a man set out a street in a new building on his own land, it is now no longer bare private interest but it is affected with a public interest.⁴⁰

This passage worked its way across the Atlantic into *Munn v. Illinois*,⁴¹ where it posed the questions of what industries were affected by the public interest and what could be done about it. On the first point, Robert Hale and Fried both recognize that various state monopolies, including common carriers and public utilities, were covered by the rule. The point of dispute was whether other industries, on which large segments of the public were dependent,

39. See *Charles River Bridge v. Warren Bridge*, 36 U.S. (11 Pet.) 420 (1837), which dealt at great length with the question of whether an exclusive franchise should be inferred when the original grant was silent on that term. The Supreme Court, in its first major decision after the departure of Chief Justice Marshall, held that the default position was that the grant was not exclusive.

40. Matthew Hale, *de portibus mari* (loosely translated: on the gates to the sea), quoted in *Allnut v. Inglis*, 12 East 527, 530, 104 Eng. Rep. 206, 208 (K.B. 1810) (emphasis added). For a longer analysis of this problem, see ERSTEIN, *supra* note 33, ch. 10.

41. 94 U.S. 113, 126 (1876).

also counted as being affected with the public interest, even when their goods and services were competitively supplied. Hale, along with leading intellectual figures of his generation, such as Walton Hamilton,⁴² took the position that the pre-1937 Supreme Court was doomed to split hairs without purpose for deciding which industries were properly subject to price regulation. All industries were so affected that it was solely a matter of public policy that determined which should be regulated and which not.

There is no doubt that the case law was muddled during much of the time that Hale wrote, and that the Supreme Court struggled with the task of classification, veering first in this direction and then that. But the soundness of the overall system is not measured by the marginal cases alone. Of equal or greater importance is the treatment at the extremes. As Fried recognizes, none of the classical writers on laissez faire insisted that regulation of monopoly industries was inappropriate: the only disputes were over its proper form.⁴³ But it was the progressives who tolerated the regulation of competitive industries, and for that mistake we all pay the price today given their complete victory in *Nebbia v. New York*,⁴⁴ which placed the kibosh on the "affected with the public interest" list by allowing the state to set minimum prices for milk.

No matter how one tugs and hauls, it is not possible to fit dairy farming into one of the traditional categories of activities affected by the public interest. The problem perceived by the farmers was that of excessive competition, for which some exit from the market was the sensible solution. But in *Nebbia* we have a system that specifies minimum prices for the sale of milk, which hardly counts as protection for consumers. At this point, the jig is really up. Only Robert Hale's formless definitions of coercion could lead you to prop up a cartel by the use of state power. But any more sober assessment of the situation suggests that social welfare is benefited by the "coercion" of a competitive industry and not by the "coercion" — i.e., old-fashioned state power — that is needed to keep the dairy cartel in line. In the end, Hale's eagerness to discredit

42. See Walton H. Hamilton, *Affectionation with Public Interest*, 39 YALE L.J. 1089 (1930).

43. As Fried rightly notes, the classical restrictive position had three parts: businesses carried out under public grants of exclusive privilege or franchise; those historical businesses such as innkeepers and common carriers and gristmills regulated as such; and last, and most amorphous, businesses in which "the owner by devoting his business to the public use, in effect grants the public an interest in that use and subjects himself to public regulation to the extent of that interest although the property continues to belong to its private owner and to be entitled to protection accordingly." P. 167. The list itself was compiled by Chief Justice Taft in *Wolff Packing Co. v. Court of Industrial Relations*, 262 U.S. 522, 535 (1923), decided the same year as Hale's famous review of Carver's *Principles*. See Hale, *supra* note 2. Clearly Taft did not regard his third class as all-embracing for he struck down the labor relations scheme presented to him in *Wolff*.

44. 291 U.S. 502 (1934).

traditional conceptions of laissez faire justifies allowing the legislature to protect cartels in what would be, without government intervention, competitive industries. The incautious use of terms like coercion can lead to adverse social consequences.

The second half of Hale's project on the public regulation of utilities addressed the proper form of regulation for those firms affected with the public interest. On this score, Hale placed in his crosshairs the bellwether decision in *Smyth v. Ames*,⁴⁵ which introduced the "fair value" limitation into American constitutional law. The motivation for *Smyth* is, at one level, easy enough to understand. The firms in question all held monopoly positions in their industry. The case for some form of rate regulation was, and is, to prevent the firm from extracting monopoly profits from its endeavors. Let that goal be achieved, and allocative efficiency is advanced because people will no longer be induced to invest in areas where the private returns are higher than the social ones. But firms must make their investments before they receive any customer revenues, so once rate regulation is allowed, the concern is whether the state regulators will permit the firm to recover the cost of its capital and make a reasonable — read competitive — profit on its investment. State regulators could easily decide to reduce the rates to the point where the revenues are higher than the variable costs of running the business, but lower than the total costs of so doing. If they are allowed to get away with that approach, then they have effectively confiscated the capital of the regulated firms. And if they do it often enough — perhaps even once — then no firms will supply the services in spite of their manifest demand.

At one level, Hale did not take issue with this basic primer on regulation. He did not think that *Smyth* was wrong because it offered invested capital some protection from rate regulation. Rather, he thought that *Smyth's* formulation was the wrong way to go. In Hale's view, use of the "fair value" limitation created a vicious circle (pp. 176-77). No one could figure out the value of the firm until the regulation was put in place, for only then could its potential revenues, on which firm valuation depended, be calculated. Hale was correct to note the difficult problems of valuation that this formula entailed, given that the firm, as an ongoing business, could not normally be sold in competitive markets. Deciding therefore which assets were still gainfully employed in the business, and which were not, was to his mind a pointless exercise.

Matters were only worse when regulators sought to evade this restriction by claiming that prices should be set to equal "what services were worth in the market" (p. 178). Given that different individuals have different subjective values, *any* system of rates will

45. 169 U.S. 466 (1898).

meet this standard for the customers that continue to use the service in question. High rates are worth it to the few customers that remain. Low rates are worth it to the many new customers that flock to the firm.

To that argument, Hale added another. It was quite pointless for the Court in *Smyth* "to believe that there existed some 'fair' rate of return on that value that would simultaneously allow the state (pursuant to its police power) to reduce the net earnings of public utilities, while (consistent with eminent domain principles) leaving the value of the utilities' property intact" (pp. 180-81). The solution? Switch the formula of rate regulation to one that essentially ties rate of return calculations to the original cost of investment. This formula was championed by Justice Brandeis in his concurring opinion in *Southwestern Bell v. Public Service Commission*,⁴⁶ which opted for a measure of value that guaranteed the firm an appropriate return on the amount of capital that it invested in the business, without asking about its fair value at any given time, and without trying to determine which fraction of it remains in service at any given time. That view continued to gain adherents until its adoption was secured in *Federal Power Commission v. Hope Natural Gas*,⁴⁷ which junked the "fair value" rule in favor of one that guaranteed the firm a bottom-line return on its "actual legitimate cost,"⁴⁸ sometimes rephrased as "actual prudent cost" (pp. 187, 197). The intention in *Hope* was to get the regulators out of the business of wading through each of the explicit assumptions incorporated in the fair value determination. A sufficient bottom-line return turned aside the constitutional challenge no matter how many mistakes were made along the way. But — a point of no small consequence — if the rates paid did not grant sufficient return, then a constitutional violation could be found.

Now that passions on this issue have subsided somewhat, how should we look at this debate today? There is no doubt that the choice of standards will have real consequences in individual cases. Yet, as the progressives understood, it was frequently unclear which side to a rate hearing benefited from the *Hope* rule. When market values are in decline, a public utility will embrace original cost as its standard. When the market values rise, the regulator becomes partial to initial cost (pp. 193-94). These malleable forensic positions of the parties tip us off as to the intellectual weakness in Hale's case. That weakness does not lie in his critique of *Smyth*: no one can deny the cost, uncertainty, and inconvenience of fair value de-

46. 262 U.S. 276, 289 (1923).

47. 320 U.S. 591 (1944).

48. See *Hope Natural Gas*, 320 U.S. at 596, 600.

terminations.⁴⁹ Rather, it lies in overstating the advantages of the *Hope* rule.

Start with Hale's knockout blows. Is the fair valuation rule circular? Well, it depends on what the rates in question are. No doubt if they are set high enough to allow the firm to remain in business, the value of the firm depends on the rates set; so to that extent, we reason in a circle. But suppose that we just reduce the rates by twenty percent across the board, as was the case in *Smyth* itself.⁵⁰ Clearly at some point, the rates have to be adjudged too low, and once we reach that point, the fair valuation requirement shows a modicum of good sense. Or stated otherwise, the point of the system is not to make sure that customers pay what services are worth, or that the firm gets a full return on its investment. Rather the task becomes the intelligible one of working our way between Scylla and Charybdis.⁵¹ Keep the rates high enough to avoid the confiscation; keep them low enough to avoid monopoly extraction; and keep the proceedings cheap enough so that all the gains from regulation are not dissipated by administrative costs.

Perhaps *Smyth* did not get the balance quite right. But *Hope* is neither toothless nor perfect. Clearly, *Hope* prescribes, as a minimum, rates that allow the regulated utility to cover its amortization payments. It is not as though the regulator gets a free pass on rate determination. Nor is the rule without difficulties of its own. Once the regulator is required to allow rates that allow the regulated firm to cover its original cost, the firm has an incentive to borrow capital, and perhaps to leverage its investment in ways that encourage firm instability. The rule could also make firms less careful to make prudent investments that are really prudent: Why should they care (as much) if they can recover full returns on an investment that doesn't quite make sense? Sometimes one has to see the return from a given investment to decide whether it was prudent, at which point the gap between *Smyth* and *Hope* starts to close. And so too the balance of advantage. The choice here is not only of near-deductive necessity, but of second-best calculations. As Fried dutifully notes (p. 197), the *Hope* rule of actual prudent costs looks a lot simpler before it bears the scars of battle than it does afterwards. The moment the rule becomes law, regulators may have to make adjustments once the revenues received depart, either up or down, from their anticipated level. Do we use these surpluses or deficits to decrease or increase the original cost basis, and if so, by what amount (p. 197)? Ultimately, it's a close call between the pure

49. Pp. 190, 191 (giving some of the costs).

50. See *Smyth*, 169 U.S. at 542, for the rollback amount of 29%, which could dampen one's day.

51. An image used by Holmes, and picked up by Fried. P. 185.

forms of *Smyth* and *Hope*. But, in practice, elements of the one bleed into the other. The entire issue is one on which reasonable people can disagree — even those of us who think that some constitutional protection must be supplied to investors in regulated industries. The Supreme Court has not returned to this issue very often, but its decision in *Duquesne Light Co. v. Barasch*⁵² shows a keen awareness of some of the difficulties in choosing standards in this area. And nothing prevents the government from deciding to defend itself using the fair value standard of *Smyth* when it thinks that this standard works to its advantage, as it has done in the looming battle over the takings issue raised by the 1996 Telecommunications Act.⁵³ So here again we have serious difficulties which await serious answers. But nothing from Hale's grand critique helps solve the real problems that are, and will remain, on the table.

CONCLUSION

Hale's mission, then, counts as a large intellectual failure. But what of Fried's? Here she is manifestly successful in the task of exposition and summarization. She is successful in the realm of criticism as well, for her Introduction and Conclusion contain a fair and balanced appraisal of Hale's work. But what is lacking is her willingness to abandon the ship that she helps to sink. Fried devastates Hale on particular points, only to praise lavishly the lasting nature of his contribution. Her parting remark is that "Hale's critical work endures as among the best examples of the Realist and institutionalist tradition, casting the nature of legal rights and private economic relations in a new and significantly different light" (p. 214).

In order to make good on that claim, she has to show how his insights organized the solution for problems of the next generation. Unfortunately, she does not show how Hale's insights advance the ball by offering new insight into union power or rate regulation. Quite the opposite, her concrete demonstrations show the danger of Hale's approach. Thus she papers over the dangerous implications of Hale's skepticism for issues of freedom of speech. After all, what is left to the First Amendment if liberty is an empty idea? It is one thing to suggest of Hale, as does Fried, that "[h]ad he been forced to address the question of expressive freedoms directly in his scholarly writing, he undoubtedly would have sided with Brandeis and Chafee" (p. 208). But it is quite another thing to square these sound sentiments with his skeptical position, or even to explain why

52. 488 U.S. 299 (1989).

53. See Implementatin of the Local Competitive Provisions in the Telecommunications Act of 1996, First Report and Order, 11 F.C.C.R. 15499, 1 869-72 (1996) (explicitly endorsing *Hope* but arguing for a "fair market value" standard reminiscent of *Smyth*).

he remained silent on the questions on which his contemporaries had delivered such forceful statements. Similarly, Fried recognizes that Hale's intellectual approach makes hash of the Takings Clause, which presupposes that all property does *not* stem from the command of the state, against whose actions the Constitution seeks to protect it (p. 209). Further, she recognizes that his expansive claim that all action is state action renders unintelligible the Equal Protection and Due Process Clauses by making private action a virtual impossibility (p. 209-10). And most astonishingly, in the end she *rejects* the centerpiece of Hale's theory, namely, his view on coercion: "There remains a difference, after all, between pointing a gun at another's head and demanding 'Your money or your life,' and threatening to withhold bread from a starving person unless she consents to pay the market price" (pp. 211-12). Precisely so. It is instructive to identify the implicit baselines that undergird that distinction, and the reasons why we accept them, which draws us back to the distinction between negative and positive sum games developed above. But Fried does not even attempt the reconstruction that saves her champion from her own criticism. And so the bottom line is this: Hale's great strength was as a provocateur, as someone who forced his intellectual opponents to reexamine the foundations of laissez faire. His great weakness, for which we should all be thankful, is that he failed to lay ruin to the intellectual foundation of the system he sought to destroy. It is that message, and none other, that Fried should have delivered to her readers.